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SUBJECT: Homes For Mongolia's Masses -- a Housing Shortage Amidst a Construction Boom?

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11. (SBU) SUMMARY. The Government of Mongolia (GOM) has launched a two-year campaign to build 40,000 affordable apartment units throughout the country (with 80 to 90% in Ulaanbaatar (UB), the capital) to address a critical housing shortage caused by increasing numbers of rural migrants moving to the cities, principally UB. Per GOM officials, the project will be partially funded by a US\$51 million government bond issue, with the GOM hoping to attract supplemental financing from private investors. The project has four formal goals: (a) place needy, ger (felt yurt in Russian) district families in affordable apartments; (b) transform traditional ger districts into modern urban developments; (c) cultivate a more professional and well-trained domestic construction industry; and (d) spur growth in the country's sluggish mortgage market. Critics pan the plan's lack of transparency and openness for corruption, asking if it has undergone proper due diligence. They are concerned that the government's politically-driven, frenzied schedule and unrealistic goals could lead to urban development "run amok" and that buildings will be of substandard quality. International financial institutions in particular worry that the plan does not accurately reflected in the government's budget, suggesting that the government invest such money elsewhere, leaving residential construction to the private sector. END SUMMARY

Government Vows to Build 40,000 Homes in Two Years

13. (U) The ambitious two-year program is the GOM's response to a critical housing shortage in Mongolia's urban centers, particularly the capital Ulaanbaatar. Tens of thousands of rural families have left the grasslands for urban areas. This migration has swelled Ulaanbaatar's population from the 500,000 residents of 1996 to the estimated 1.2 million in 2007, more than doubling over the last decade. Starts of affordable housing starts have failed to keep pace. Consequently, 60% of UB's one million inhabitants have moved their felt tents or gers (most lacking electricity; almost all lacking water and sewage facilities) into overcrowded checkerboard-like "ger" districts that surround UB and other major cities, straining an already limited infrastructure.

Housing Boom or Bust?

14. (U) Ironically, this housing shortage comes at a time of unbridled housing development. Government statistics show that nationwide privately financed housing starts in 2006 nearly doubled over 2005 figures to some 8,000 units. Real estate industry figures show that property prices in Ulaanbaatar have jumped 18% in the last year alone and most apartments now under construction (middle and high end) will rent for US\$1000 per month or more. Some are now afraid that this could be a housing bubble in the making, as the market of for US\$1000 apartments may be limited to expats and the relatively small Mongolian upper classes, who already have housing.

15. (U) Yet, speculators and developers hope that the country's surging mining sector will attract floods of expats looking for western-style, upscale accommodations. These hopes have attracted investments in Ulaanbaatar's housing market from Japan, South Korea, China, Russia, the Netherlands, Malaysia, the United States and Singapore. European newspapers tout Ulaanbaatar as the "hot" market for real estate investors. Ubiquitous billboards around UB advertise swank housing developments with western sounding names like "Marshall Town" and "Four Seasons" (the latter renamed, as "Japan Town" grated on some). To be sure, such developments remain well out of reach to all but the wealthiest buyers. But a burgeoning middle class of Mongolians who work for expat mining companies or other international organizations and who are on average paid a salary four to six times greater than the national average of US\$150 a month are also looking to "move on up" to better accommodations, if not these high-end homes. With most housing starts targeting upper and mid-income buyers, low-income ger district residents are left out in the cold.

16. (SBU) Hyper-sensitive ruling party MPRP politicians, desperate to head off a potential upheaval from the city's poor just before

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mid-2008 elections, essentially hijacked what had been a 2004 Democratic Party election promise to provide thousands of low-cost apartments with low-interest mortgages. While Democrats may resent the MPRP's taking credit for their idea, the program nevertheless enjoys wide support within the government. Mongolia's Prime Minister Enkhbold, a former UB mayor, is a major backer of the plan (Note: nagging rumors persist that both he and the current mayor of UB are personally benefiting financially from some of the construction projects).

Details of the "Master Plan"

17. (U) The "master plan" calls for the construction of 40,000 apartment units by 2009, with 80 to 90% in Ulaanbaatar and the rest sprinkled throughout the country in aimag centers and some larger townships or "soums." New apartment complexes will be built in areas now occupied by ger districts and undeveloped tracts outside the city centers. Where the government will not build apartment blocks, it plans to install the proper infrastructure that will entice private sector investors to build on the site. Vacant land near Ulaanbaatar's airport, near the children's camp to the west of the city and an area on the city's east side are slated for development. Recently, the government also submitted to parliament to free the Yarmag area in the Khan-Uul District from the Bogd Khan Uul Strictly Protected Area in order to make space for housing projects. A number of foreign companies have expressed strong interest in building a modern residential town in the Yarmag area.

18. (SBU) G. Myagmar, Director of the Policy and Coordination Department of the Ministry of Construction and Urban Planning, whose office will have primary oversight of the plan, recently told Econoff that the building program will coincide with Millennium Development construction projects that will continue until 2020, when the GOM hopes that 80% of its population will be properly housed. But he conceded that with an estimated 136,000 ger districts families in need of housing, 40,000 apartments is only a modest start.

19. (SBU) Myagmar said the plan has five objectives: 1) building of mini-town-like housing projects including all necessary

infrastructure, 2) constructing new buildings on existing infrastructure, 3) transforming ger districts into apartment blocks, 4) developing small and medium business in the construction sector that will lead to the creation of a more professional and well trained class of construction sector workers, and, 5) creating a genuine housing and mortgage market.

Cranking up the Domestic Mortgage Industry

¶10. (SBU) GOM representatives tacitly acknowledge that the real aim of the plan, in addition to providing much needed housing, is to spur growth in the country's nascent mortgage industry, which they hope will, in turn, generate more investment in housing development. Mongolia's current mortgage industry is weighed down by lack of a legal framework and by a population still uncomfortable with the idea of private property ownership. Ancillary services such as housing insurance, mortgage appraising, etc, are non-existent, and confusing signals from the GOM on foreclosure laws and enforcement make loaning large sums risky to all but the most credit worthy customers. A draft law on mortgages that includes language on foreclosures is now winding its way through parliamentary subcommittees with no specific passage date in sight.

¶11. (SBU) To oversee the mortgage angle of the plan, as well as to expand the country's mortgage industry in general, the GOM established the Housing Finance Corporation (HFC), a byproduct of a successful Asian Development Bank (ADB) program with the same objective that ended earlier this year. The ADB declined GOM pleas to extend its program believing it was time the private industry step in and carry the ball. J. Jargalsaikhan, President of HFC, told Econoff that the experience gained under ADB was invaluable and that his organization wanted establish contact with mortgage and housing experts in the U.S., such as the Department of Housing and Urban Development, Fannie Mae Corporation and U.S. real estate companies.

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¶12. (SBU) HFC admitted that although the 40,000 apartment plan is primarily aimed at low and middle income Mongolian's, no means testing would be used for those who had money to purchase the units outright and nothing would preventing well-off Mongolians from taking advantage of low cost housing. He fully expected many of the units, mostly one-bedroom apartments, to be purchased through remittances by Mongolians working overseas in Korea, Japan or the U.S.

Critics: Plan Not Transparent, Open to Corruption

¶13. (SBU) Housing experts and representatives of international financial institutions in Mongolia have strongly criticized the lack of means testing, in addition to other problems with the plan. An overall lack of transparency in the development process has led many to speculate that the freshly built apartments will actually go to those who have the right political connections. Those who lack "friends in high places" may stoop to exploit the poor as fronts to obtain low interest mortgages. Unlike some countries which lure teachers or police to buy properties in certain areas with guaranteed low interest mortgages as long as they promise to remain in the property for 10 years or more, Mongolia has no such provision, and many fear the rich will simply pay poorer families to occupy the apartments for a year or so, then either "flip" them or rent them out at much higher prices. The IMF rep wondered whether a thorough due diligence was done on the project and voiced concerns about how the project is being advertised, if at all, to the very ger district residents in is intended to benefit.

¶14. (SBU) Others grumble that the plan in general was not well thought through, that GOM estimates on financing and construction costs are wildly optimistic, would have been better left to the private sector, and that this was yet another example of the GOM spending foolishly and not girding itself for inevitable price fluctuations in commodity prices that make up the backbone of the Mongolian economy.

Project Financing: Fuzzy Math?

¶15. (SBU) Some IFI representatives complain that the project is not clearly reflected in the government's budget and have questioned the fiscal math behind issuing Tugruk 60 billion (about US\$52 million) in bonds to finance the project. One IFI rep opined "with savings account interest rates so high (16% to 20%), how can the government expect to make low yielding bonds attractive to investors? They will have promise a return of at least 10% to stay competitive, but how can they then turn and use that money to finance low interest mortgages?"

¶16. (SBU) The local IMF rep, however, felt the GOM would have no problem finding buyers for its bonds, even at lower rates: "Mongolian banks and investors are looking for safe harbors to store the overabundance of liquidity now sloshing around the country." He pointed to the sale of the first Tugruk 10 billion tranche in January on Mongolia's normally sleepy stock exchange. One local bank, Khan Bank, gobbled this issue up within minutes. The IMF Rep opined that bond sales remain brisk, noting that when it came to bonds "crisis-prone Mongolia is doing better than Ford Motors."

¶17. (U) Banks appear to be resisting the idea of issuing subsidized mortgages to low-income buyers. They want market rates instead and feel that it is the only way to ensure the program will be sustainable. USAID, through the Economic Policy Reform and Competitiveness (EPRC) project, is about to bring an expert to help design a targeted subsidy system that will allow banks to get market rates for mortgages while the qualified low income families will have their costs reduced, most likely by down payment support. This would be a much more effective use of government financing than the current GOM plan to provide subsidized low interest loans to builders for construction and to banks for mortgage capital. USAID has been trying to help the private sector housing finance market by providing extensive support to the Mongolia Mortgage Corporation and consulting with GOM lawmakers on the mortgage security law and other laws to support asset backed securities.

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¶18. (SBU) Still, others believe Mongolia could invest its new mining wealth more wisely and feel that the 40,000 apartment housing project, along with social welfare payments to newlyweds, newborn children and monthly child allowances are simply throwbacks to grand "Plans" of the socialist era. "Without the GOM properly investing in infrastructure and social safety nets, grand schemes like the 40,000 apartments will crumble when commodity prices fall," one IFI rep commented.

Build First, Think Later

¶19. (SBU) The local ADB rep expressed concern that this project was urban expansion "run amok". Quickly assembled large-scale construction projects like this, he said, often leave no room for proper urban planning. For example, one of the plan's largest developments is to be located next to Ulaanbaatar's Chinggis Khan Airport. "Has there been any thought given to the consequences of building high-rise apartments so close to the airport's single runway?" he mused. As far as post can tell, the GOM has not asked let alone answered the question.

¶20. (SBU) A representative from the German Aid Organization GTZ, who has been working with the GOM on an urban development and vocational education program, feared that quality would be sacrificed as the GOM tried to keep prices low. He complained that the government would use poor quality building materials from China and Korea and that absolutely no thought had been given to making the buildings earthquake resistant even though Ulaanbaatar lies in a seismically active zone. Also, the tall tenement blocks envisioned by the government would undoubtedly create tunnel effect winds that would kick up even more dust than usual leading to even greater pollution problems.

¶21. (SBU) The local rep from the ADB wondered aloud if the 40,000 apartment program might lead to a housing glut (in this category of housing), doing more harm than good for the private construction industry and possibly exposing Mongolia's banking system, already saddled with a high ratio of non-performing loans, to even greater risk. Despite a government survey's indicating otherwise, he doubted the demand was really there. Although impoverished ger-district dwellers have told survey takers "they would love to move to new apartments," most ger districts residents lack the stable incomes lenders require and could not afford a mortgage at any interest-rate.

¶22. (SBU) On the supply side, the local World Bank representative felt government promises were unrealistic. "The GOM could maybe supply 15,000 units within two years," he said, pointing out that so far only one project had started production. He asked, "How much could the government hope to achieve this year before the harsh winter put a halt to construction projects (Note: the construction season runs from May to October) until next year?". He surmised the other 25,000 units could possibly be developed through private sector financing with the government taking credit for their construction thanks to their "enlightened" housing policies.

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